

Types of Stock

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WHAT'S COVERED

In this lesson, you will learn about common stock and preferred stock. Specifically, this lesson will cover:

1. Common Stock

Common stock, a term used primarily in the United States, is a security that represents ownership, or equity, in a corporation. In other parts of the world, the terms “voting share” or “ordinary share” are used to represent this same concept.

Now, common stock is called “common” in order to distinguish it from another type of stock known as preferred stock. In the case that a corporation has issued both common and preferred stock, holders of common stock must wait to be paid **dividends** until after preferred stock shareholders receive all dividends, including payments in arrears.

In the event that a corporation goes bankrupt, those shareholders with common stock will only receive the funds that remain after preferred stockholders, bondholders, and creditors - including employees - receive their funds. Therefore, when a company liquidation occurs, common stock shareholders typically receive nothing.

While common stockholders are generally last in line among other creditors to receive assets should the business in question go bankrupt, common shares do tend to perform better than preferred shares over time. Also, common stock usually carries the right to vote on certain matters. These matters include, but are not limited to, deciding who gets to sit on the board of directors of the company. However, a company can have both a “voting” and “non-voting” class of common stock.

Common shareholders do not get guaranteed dividends, so their returns can be uncertain. It must be remembered that preferred stock generally does not carry voting rights. As common stockholders, these shareholders have the ability to influence the corporation, as they are entitled to vote on corporate matters such as creating corporate objectives and policy, stock splits, and the election of the corporation’s board of directors.

Common stock also bestows preemptive rights upon those shareholders, which means that common stockholders can retain their proportional ownership in a company, having a right of first refusal on buying any new stock that the company might attempt to issue.



TERMS TO KNOW

Common Stock

A form of equity and type of security; also known as a voting share or an ordinary share.

Dividends

Payments made by a corporation to its shareholder members.

2. Preferred Stock

Another type of stock, mentioned above, is preferred stock, a term used interchangeably with preferred shares, preference shares, or preferred.

Preferred stock is a hybrid between common stock and bonds, as an equity security retaining properties of both an equity and debt agent. It is considered to be less risky than common stock but more risky than bonds in terms of a shareholder's claim or rights to their share of a corporation's assets. In other words, in the case of liquidation or bankruptcy, preferred stock will have claim to assets before common stock, but after corporate bonds or other debt instruments.

There is a unique set of features and rights associated with preferred stock, such as the lack of voting rights, although it may carry a dividend and as discussed above, will have a prioritized claim to dividends as well as assets in the event of a company's liquidation. The specific terms of owning preferred stock are specified in a certificate of designation.

In addition to the lack of voting rights and preference in dividends and liquidation assets, preferred stock is convertible to common stock, and it has a callability feature that can be used at the discretion of the issuer. Preferred stocks are rated by the major credit rating companies, just like bonds, although their rating is typically lower than bonds because preferred dividends do not carry the same guarantees as interest payments from bonds, and they are junior to all creditors.

Details with regards to the rights associated with preferred stock will vary with the business entity that issues the shares, and preferred stock can come in a number of different classes.

Some examples are:

- Prior preferred stock (highest priority)
- Preference preferred stock
- Convertible preferred stock (exchangeable for common stock)
- Cumulative preferred stock
- Exchangeable preferred stock
- Participating preferred stock
- Putable preferred stock
- Monthly income preferred stock
- Non-cumulative preferred stock



TERM TO KNOW

Preferred Stock

An equity security that has the properties of both an equity and debt instrument and is higher ranking than common stock.



SUMMARY

In this lesson, you learned that **common stock** is a type of stock that typically carries voting rights within a company. However, common stock extends fewer financial benefits than other classes of stock. In particular, common stockholders are not guaranteed to receive dividends, and in the case of company bankruptcy, they must wait behind creditors and other classes of stockholders to receive assets. **Preferred stock**, on the other hand, does not carry voting rights, but it does claim priority over common stock when it comes to dividends or asset recovery in the case of company liquidation.

Best of luck in your learning!

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TERMS TO KNOW

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Dividends

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Preferred Stock

An equity security that has the properties of both an equity and debt instrument and is higher ranking than common stock.